ST 95-10
Tax Type: SALES TAX
Issue: Statute of Limitations Application
Unreported/Underreported Receipts (Fraud)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	Docket No. XXXXX
	)	NTL No. XXXXX
	)	Reg. No. XXXXX
v.	)	
	)	
XXXXX	)	
	)	Alan Osheff
Taxpayer	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Mr. Marc Muchin, Assistant Attorney General, on behalf of the Department of Revenue; XXXXX on behalf of the taxpayer.

SYNOPSIS: The taxpayer is XXXXX ("taxpayer"), an Illinois Corporation licensed to do business in the State during the relevant time periods. The Department of Revenue (hereinafter referred to as the "Department") issued a Notice of Tax Liability ("NTL") dated XXXXX for the audit period of January 1, 1987 to December 31, 1990, which totaled $26,129.00 inclusive of tax, interest and a 30% fraud penalty. The Department has admitted that there's no tax liability for 1989 or 1990. The taxpayer signed a waiver of statute of limitation for January 1, 1988 through December 31, 1991 on May 21, 1991.1

On the grounds of fraud, the Department seeks to hold the taxpayer liable for 1987 corrected taxes, even though the NTL was dated and issued beyond the three-year statute of limitations. The Department further seeks to hold the taxpayer liable for 1988 for underreporting the Retailer's Occupation Tax ("ROT"). For both 1987, and 1988, the Department has added interest and a 30% fraud penalty.

Taxpayer contends:

(1) that pursuant to the pertinent provisions of 35 ILCS 120/4 that the tax assessment for calendar year 1987 is barred under the three-year statute of limitations;

(2) that the fraud exception to the three-year statute is not applicable in the instant case;

(3) that the tax assessment of the year 1988 is barred by the statute of limitations;

(4) that the Department has failed to establish fraud by clear and convincing evidence; and

Department contends:

(1) that the tax assessment for 1987 is not barred by the three-year statute of limitations since the under-reporting is based on fraud;

(2) that according to the pertinent provisions of 35 ILCS 120/4, since a Department corrected return is deemed prima facie correct, then the assessment of a fraud penalty establishes a prima facie case of fraud;

(3) that the taxpayer signed a waiver for 1988.

(4) that the taxpayer has not overcome the prima facie case, as to the correctness of the taxes due for 1987 and 1988.

(5) that as to those periods within the statutory period the taxpayer offered no competent evidence to overcome the statutory presumption.

_____

1. The first six months would have been outside the statutory period had the taxpayer not signed a waiver for that period.

RECOMMENDED DECISION: For the reasons hereinafter set forth, I am of the opinion that the three-year statute of limitations would have barred the Department from correcting the 1987 tax return of the taxpayer; further, the Department failed to present clear and convincing evidence of fraud for those periods; therefore, I rule in favor of the taxpayer for the calendar year 1987.

As to 1988, the Department correctly relied upon the statutory presumption that the Notice of Penalty Liability is presumptively correct and the taxpayer failed to present sufficient evidence to rebut the

statutory presumption, therefore I rule in favor of the Department for the calendar year 1988. However, the 30% fraud penalty should be deleted since the Department presented no evidence of fraud.

The following exhibits were introduced by the parties:

Department Exhibits:

(1) Corrected return, 1-1-87 through 12-31-88, dated 5-16-91.

(2) MROT, 1-1-87 through 12-31-88, dated 5-16-91.

(3) RTA, 1-1-87 through 12-31-88, dated 5-16-91.

(4) NTL dated 10-25-91.

(5) Group Exhibit, schedules of auditor.

(6) Schedules prepared by Ms. Kaplan.

Taxpayer Exhibits:

(1) DOR letter, dated 1-22-91 (12-22-93).

(2) DOR letter dated 11-8-91.

(3) DOR questionnaire compl. by taxpayer, dated 12-19-91.

(4) NTL, dated 10-25-91 and received by taxpayer 3-9-92.

(5) Letter dated 2-9-92 from accountant to DOR.

(6) Taxpayer's monthly sales reports.

(7) A schedule comparing XXXXX's findings with that of Ms. Kaplans.

(8) A part of DOR's Group Exhibit 5 and taxpayer's daily receipts.

(9) ROT returns filed with DOR.

Court Exhibits:

1-9 - copies of vendor printouts.

10 - Schedules prepared by Ms. Kaplan.

FINDINGS OF FACT:

1. Taxpayer's business was incorporated in 1980. (Tr. Dec. 22, page 62).

2. The corporation was dissolved on February 1, 1985. (Tr. Dec. 22, page 65).

3. XXXXX was owner and president of XXXXX for the relevant time period. (Tr. Jan. 12, page 46).

4. Randi Kaplan, a special agent for DOR conducted the investigation of the taxpayer and prepared the underlying documentation. Ms. Kaplan then prepared an investigative summary report. (Tr. Dec. 22, pages 105-106).

5. Ms. Kaplan personally spoke with taxpayer on January 1, 1989 and on other occasions. (Tr. Dec. 22, pages 68-69).

6. The taxpayer informed Ms. Kaplan that he does all the buying and ordering of merchandise and that at the end of each day he does not write down a total receipts figure. (Tr. Dec. 22, page 70).

7. Taxpayer further stated to Ms. Kaplan that at the end of the day he deposits the total receipts in the bank. (Tr. Dec. 22, page 71).

8. On August 18, 1989, Ms. Kaplan obtained the books and records of taxpayer, which included Retailer's Occupation Tax Returns for 1987 and 1988, bank statements from the Bank of Alsip from 10/87-6/88, purchase invoices from 4/87-12/88, a computer printout of a general ledger, monthly summaries for January and February 1987 and from 7/87 through 12/88, (Tr. Dec. 22, pages 71-73).

9. Investigator Kaplan claimed she subpoenaed vendor records for this particular taxpayer yet, upon cross examination of this witness she was unable to produce a copy of the subpoena clearly indicating the records she received were for the business in question.

10. Although Investigator Kaplan received business records from nine different vendors who supposedly did business with the taxpayer, upon cross-examination of this witness, as to these particular vendors, I determined the following findings of facts:

(a) Court Exhibits 1-9 were marked (Tr. p. 130, Dec. 22) as being printouts shown to the investigator.

Exhibits
1 - XXXXX
2 - XXXXX
3 - XXXXX
4 - Computer printout with no name
5 - XXXXX
6 - XXXXX
7 - XXXXX
8 - XXXXX
9 - XXXXX

(b) Records of XXXXX and XXXXX (Exhibit 1) - The investigator was unable to determine from the printout which items may be food (Tr. p. 119) - December 22, 1993).

(c) Records of XXXXX (Exhibit 2). The investigator never spoke with anyone from the company nor reviewed any of the underlying invoices even though this particular printout pertained to more than one business (Tr. p. 120 - December 22, 1993). The witness conceded that as to this particular printout there was some handwriting on the document which was not hers and she further responded with an answer of "correct" to the following question:

> "I would take it then with respect to the numbers that are shown on here, you do not know what specific items they refer to."

(d) In regards to the XXXXX (Exhibit 3) computer sheet, the investigator conceded she never spoke with anyone from that company. She never reviewed any of the invoices. She didn't know which items those numbers referred to (Tr. pp 120, 121 - Dec. 24). Further, as to this printout, the document did not contain the name of the taxpayer. (Tr. p. 121 - Dec. 28). According to the investigator someone had written the name "XXXXX" on the computer printout (Tr. p. 122 - Dec. 22).

(e) As to XXXXX, (Exhibits 5, 6) the computer sheet bore the name "XXXXX. The investigator could not recall if she contacted the

company to make certain this printout was that of this particular taxpayer eg. XXXXX (Tr. p. 122 - Dec. 22). As to this particular company she never received any invoices.

(f) As to XXXXX, (Exhibit 8) the investigator conceded she reviewed no underlying invoices and spoke to no one from that company. She further testified, she could not analyze the document without the assistance of someone from XXXXX to explain the codes contained on the document.

(g) As to XXXXX, (Exhibit 9) the investigator also required the assistance of a company employee to decipher the codes contained on the document.

10. For periods beyond the statute of limitations e.g. January 1, 1987 through June 30, 1988, the Department of Revenue relied merely upon the testimony of Randi Kaplan, Department investigator, to prove by clear and convincing evidence that the taxpayer had filed fraudulent returns for periods prior to July 1, 1988. The auditor who prepared the audit was not called to testify to clearly expound as to her imposition of a 30% fraud penalty for those periods beyond the statute of limitations.

11. The Department never called any witnesses from the respective vendors whom the investigator claimed the taxpayer had purchased items from these vendors. The Notice of Tax Liability (NTL) was issued on XXXX.

12. The taxpayer waived the statute of limitations for the period after January 1, 1988 when he executed a waiver.

13. At the time the NTL was issued the taxpayer had destroyed his records for 1987 (Tr. p. 55 - January 12, 1994).

14. For the year 1988, the taxpayer's testimony was not sufficient to rebut the statutory presumption that the tax imposed by the Department, was prima facie correct since he failed to introduce any documents identified with the books and records of the business.

CONCLUSIONS OF LAW:

35 ILCS 120/4 states:

> "Provided, that if the incorrectness of any return or return as determined by the Department is due to fraud, said penalty shall be 30% of the tax due. If the Notice of Tax Liability is not based (emphasis added) on a correction of the taxpayer's return or returns, but is based on the taxpayer's failure to pay all or a part of the tax admitted by his return or returns (whether filed on time or not) to be due, such Notice of Tax Liability shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax (emphasis added) due, as shown therein."

In my opinion the Department's argument that the introduction of the NTL alleviates the requirement to prove that a fraudulent return was filed is not tenable. The Department's reliance upon the foregoing language in 35 ILCS 120/4 is unfounded.

The language of the statute clearly states that this provision is only applicable when the Notice of Tax Liability is not based on a correction of taxpayer's return. In the instant case the NTL was based on a corrected return. Secondly, NTL, according to the statute, is only prima facie evidence of the correctness of the tax due. The language of the statute does not make it clear that the presumption should be inclusive of penalty and interest. The purpose of a statute of limitation period is to require a taxpayer to preserve his records until the statutory period has elapsed. A taxpayer would be disadvantaged if the Department could arbitrarily determine that a fraud penalty should be included in the NTL and upon issuance of the NTL the fraud penalty was presumed correct. The Department in my opinion is required to show by clear and convincing evidence that a fraudulent return was filed.

The requirement to show by clear and convincing evidence that a fraudulent return was filed is predicated upon the language in Brown Specialty Co. v. Allphin 75 Ill. App. 3d 845 (3rd Dist. 1979) when that Court stated that the Department failed to prove by clear and convincing

evidence that the taxpayer had filed fraudulent returns.

In the instant case, the Department relied upon the testimony of Randi Kaplan and the schedules prepared by her in an effort to show by clear and convincing evidence that the taxpayer had filed fraudulent returns; ordinary, the method employed by the investigator is an accepted practice; however, a review of her testimony does not present a picture of clear and convincing evidence that the documents she relied upon were either those of the taxpayer or the information presumably contained therein was capable of being properly interpreted without the assistance of third parties whom she admitted she had not spoken to.

The Department was attempting to show through these schedules prepared by Randi Kaplan that the dollar amount of purchases for any given month exceeded the dollar amount as reflected on line 19 of the monthly ROT returns. According, to the schedules prepared by Ms. Kaplan, these excess purchases versus line 19 occurred continually for the year 1987. As heretofore stated, although Ms. Kaplan's analysis is sound from a theoretical stance, her inability to link those subpoenaed documents to the taxpayer is the weakness of the Department's case. In addition, those documents which she could identify as being those of the taxpayer, she conceded that she could not always clearly interpret the codes contained therein. More specifically, on some of the invoices she reviewed, the complete name of the taxpayer did not appear; rather the word XXXXX appeared on the documents. The witness conceded she took no further steps to insure that these particular invoices related to this taxpayer. As to one printout (XXXXX) she conceded she could not analyze the document without the assistance of someone from XXXXX to explain the codes. Yet, the witness admitted she spoke to no one from XXXXX. She admitted she would have needed assistance from an employee of the vendor to decipher the codes of XXXXX printouts. As to the records of the XXXXX and XXXXX, the witness

could not determine from the printout which items may have been food items which could account in some measure for the discrepancies of the dollar amounts on line 19. Since her schedules were prepared based upon information contained in those printouts, I find her testimony to be neither clear nor convincing to allow myself to conclude, that information contained in those schedules, were sufficiently accurate or if accurate they were attributable to this taxpayer.

As to the year 1988 the Department relied 35 ILCS 120/4 which states:

> Proof of such notice of tax liability by the Department may be made at any hearing or in any legal proceeding by a reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director. Such reproduced copy shall without further proof (emphasis added), be admitted into evidence .... and shall be prima facie proof of the correctness of the amount of tax due, as shown therein."

Unlike 1987, 1988 was not beyond the Statute of Limitations, since the taxpayer signed a waiver.

Once the Department introduced the NTL, it was incumbent upon the taxpayer to produce competent evidence, identified with their books and records showing that the Department's returns are incorrect. Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 454 N.E. 2d 799 (3rd Dist. 1978) The taxpayer could not prevail by merely saying that its own retailer's occupation tax return was correct and the Department must prove its return correct; simply questioning the Department's return or denying its accuracy does not shift the burden to the Department, Quincy Trading Post, Inc. v. Department of Revenue, 12 Ill. App. 3d 725, 298 N.E. 2d 789, (4th Dist. 1973).

In the instant case, the admission of the NTL into evidence, according to 35 ILCS 120/4, elevated it to being prima facie proof of the correctness of the amount of tax due. This presumption applies to the amount of the tax. Since the Department corrected the return, the imposition of a fraud penalty could only be sustained by the Department presenting clear and

convincing evidence Brown Specialty Co. v. Allphin; supra. Since the Department offered no evidence as to the fraud penalty, I find that the fraud penalty should be deleted. The auditor, who was present at the hearing, could have been called to testify to explain her rationale in imposing a 30% fraud penalty. If the auditor was relying upon the findings of the investigator, I have already ruled upon the credibility of that testimony in disposing of the year 1987. My rational for 1987, would apply for the imposition of the fraud penalty for 1988.

RECOMMENDATION: Based upon the foregoing, it is my opinion that 1987 should be deleted from audit and 1988 should be finalized per the NTL except the 30% fraud penalty should be deleted.

Alan Osheff
Administrative Law Judge